

PROCUREMENT FRAUD

1. Introduction. One of the high visibility programs in government contracting today is the elimination of fraud, waste, and abuse. With continued budget cuts, it has become imperative that the Government be successful in combating procurement fraud. Fraud may be committed or perpetuated by contractor or Government personnel, and may occur at any stage of the procurement process. Fraud can have criminal, civil, contractual and administrative ramifications. Acquisition personnel are subject not only to the general ethics statutes and regulations which affect all Federal employees, but also to the provisions of the Procurement Integrity Act which has stringent requirements for dealing with both contractor personnel and information.

2. Objectives. After completion of this block of instruction, the student should be able to:

- a. Discuss common types and indicators of possible procurement fraud.
- b. Discuss the Procurement Integrity Act as it applies to the acquisition workforce.

3. Policies.

a. DoD policy requires that each component establish a centralized organization to monitor significant fraud and corruption cases, and coordinate all possible criminal, civil, administrative and contractual remedies. Coordination with Department of Justice and DoD investigative agencies is required during investigation and before prosecution and litigation to ensure that all appropriate remedies are pursued and that action is taken to recover funds lost through fraud or corruption.

b. The single centralized organization within the Army responsible for the coordination and monitoring of all significant cases of fraud and corruption relating to Army procurements is the **Procurement Fraud Division, Office of the Judge Advocate General**. Army policy requires that procurement fraud and irregularities be promptly reported and thoroughly investigated.

c. Command counsels and Staff Judge Advocates at major commands develop a procurement fraud and irregularities program and appoint an attorney as **Procurement Fraud Coordinator** for their commands. Chief counsels and Staff Judge Advocates at commands with procurement advisory responsibility appoint an attorney as **Procurement Fraud Advisor** to manage their installation programs. These Coordinators and Advisors are responsible for coordination with the appropriate Army Criminal Investigation Command or Defense Criminal Investigative Service office to assure the prompt notification and coordination of all procurement cases.

4. Procurement Fraud. Fraud is characterized by acts of guile, deceit, trickery, concealment or breach of confidence which are used to gain some unfair or dishonest advantage. Fraud may occur at any stage of the Government contracting process. The motives and methods for fraud in the contracting process are varied. Sometimes the fraud is perpetrated in order to have the opportunity to engage in theft, embezzlement, or other kinds of fraud. Sometimes it is done in order to obtain a higher price for the contract. Frauds are sometimes committed with the assistance of DoD employees.

5. Antitrust Violations. Collusive bidding, price fixing, or bid rigging are commonly interchangeable terms that describe many forms of **illegal anticompetitive activity**. The common thread is that they involve agreements or informal arrangements among independent competitors which limit competition. Collusive bidding or price fixing completely undermines the Government's efforts to use competitive contracting methods. They also result in increased costs and can destroy public trust in the integrity of the contracting process.

6. Defective Pricing. Under the Truth in Negotiations Act, contractors may be required to submit cost or pricing data prior to negotiations and to certify that such data was accurate, complete and current as of the close of negotiations. The submission of defective data, i.e., inaccurate, incomplete or noncurrent data, entitles the Government to a price reduction under a contract clause used whenever certified cost or pricing data is required. The mere existence of defective cost or pricing data does not by itself indicate fraudulent conduct, and recovery under the contract clause is not based on fraudulent intent. However, sometimes contractors **knowingly** submit defective data during negotiations. This kind of defective pricing does constitute fraud. Some of the most significant fraud **indicators** in defective pricing cases are: (1) falsifications or alterations of supporting data; (2) failure to update cost or pricing data with knowledge that past activity showed that prices have decreased; (3) failure to make complete disclosure of data known to responsible contractor personnel; (4) distorting of overhead accounts or base line information by transferring charges or accounts that have a material impact on Government contracts; (5) protracted delay in release of data to the Government to preclude possible price reductions; (6) repeated denials by responsible contractor employees of the existence of historical records that are subsequently found; (7) submitting fictitious documents; (8) failing to disclose internal documents on vendor discounts; and (9) nondisclosure of actuals for follow-on contracts.

7. Cost Mischarging. Many DoD contracts are large cost-reimbursement contracts which provide a great temptation to contractors willing to take the risk after award to mischarge costs knowingly and willfully. The impact of mischarging costs is almost always far greater than the basic costs which were falsified. For example, a single hour of mischarged labor may result in payments of as much as three times the labor hour rate due to indirect cost allowances which are added based on that hourly rate.

a. The type of cost mischarging most frequently found by auditors is **accounting mischarging**. Accounting mischarging occurs when a contractor knowingly charges unallowable costs to the Government or conceals or misrepresents unallowable costs as allowable. Other practices include hiding unallowable costs in accounts (e.g., office supplies) which are not closely audited or by charging costs which have reached their limit (e.g., bid and proposal costs) to other cost categories.

b. **Material cost mischarging** occurs when the contractor transfers Government-owned material from Government contracts to commercial contracts, orders and charges for materials in excess of contract requirements, transfers material costs from ongoing jobs to other work orders for previously delivered materials, or charges material costs in amounts substantially different than actual costs. Material mischarges are generally restricted to instances involving raw materials or interchangeable parts.

c. **Labor mischarging** occurs when the contractor charges the Government for work not actually performed. Labor mischarging schemes range from very crude to very sophisticated. Some of the more common methods include: transferring labor costs from fixed price contracts to cost type contracts; billing the Government for unsubstantiated time and charges; destroying original time cards and preparing new ones; and changing individual time cards.

8. Product Substitution. Product substitution refers to attempts by contractors to deliver nonconforming goods or services without informing the Government of the deficiencies. The contractors then bill and accept payment on the basis of conforming goods. Product substitution may have serious consequences if critical inferior items are delivered which affect the safety of the user. For example, investigations revealed that weak bolts in the Army inventory caused wheel assembly failure on a variety of Army vehicles, including the Humvee. Fraud in product substitution cases may result from the use of inferior quality raw materials, failing to test materials as required or falsifying the test results, providing foreign-made products when domestic are contractually required, and providing unskilled workers when skilled technicians are required. The key to product substitution cases is that the contractor is knowingly substituting materials, labor, and/or end products which do not conform to the requirements of the contract.

9. Progress Payment Fraud. Progress payments are payments based on costs incurred, or on the percentage or stage of completion. Most progress payments are not audited before payment, the Government relying on the integrity of the contractor. Progress payment fraud cases generally involve falsified labor charges for work not performed, charges for materials not actually purchased, or the false certification of the percentage or stage of completion.

10. Remedies. The Government can take a variety of actions against contractors who engage in fraudulent activities. Some of these arise under contract law principles, some under contracting regulations, some under civil statutes, and some under criminal statutes. DoD policy is to take a coordinated approach to combating fraud. A coordinated approach includes not only early contact among the investigative agencies, but also the timely identification and consideration of all possible remedies. Within the Army, the Procurement Fraud Division, Office of the Judge Advocate General, is responsible for oversight of coordination of remedies.

11. Ethics. The single source of standards of ethical conduct and ethics guidance for DoD is DoD 5500.7-R, Joint Ethics Regulation (JER). It includes direction in the areas of financial and employment disclosure systems, post-employment rules, enforcement, and training. The JER consolidates a number of general and specific regulations and statutes which affect DoD employee conduct. Among these are: the Office of Government Ethics regulation, 5 CFR 2634; conflict of interest, 18 USC 208; and procurement integrity, 41 USC 423. To administer the provisions of these regulations and laws, each of the military departments and Defense agencies has appointed a Designated Agency Ethics Official (DAEO). This official has the authority to appoint a deputy, alternate, and ethics counselors.

12. Procurement Integrity Act.

a. The Procurement Integrity Act, originally passed in 1988 and amended several times since, focuses on improper contacts between contractor and Government personnel. The Act specifically addresses offers of employment, disclosure of information, and compensation of former officials. Violators are subject to a variety of remedies including criminal prosecution, civil suit, and administrative actions.

b. Any Government employee with access to contractor bid or proposal information or source selection information may not, except as provided by law, disclose that information prior to award. No one, except as provided by law, may knowingly obtain such information before award. These prohibitions apply regardless of dollar value of the proposed contract. However, no such information is generated in micropurchases.

c. A Government employee "participating personally and substantially" in a procurement estimated to be above the simplified acquisition threshold must report an offer of non-Federal employment by a bidder or offeror. The employee has two choices: reject the possibility of such employment, or disqualify himself from further participation in the procurement.

d. Certain Government employees may not accept compensation from a contractor as an employee, officer, director, or consultant of the contractor within one year of being involved with the contract. Named positions covered by this prohibition include the procuring contracting officer, source selection authority, member of the source selection evaluation board, program manager, deputy program manager, and administrative contracting officer. The prohibition applies when the contract action is in excess of \$10,000,000.

13. Summary. When procurement fraud or corruption is suspected, immediate coordination should be made between the contracting office and the local Procurement Fraud Advisor. Which contractual, administrative, civil, and/or criminal remedies should be pursued depend on the specific facts and circumstances of each case. Acquisition personnel need to be aware of the indicators of procurement fraud and of their responsibilities under the Procurement Integrity Act.

14. References:

- a. FAR Part 3, Improper Business Practices and Personal Conflicts of Interest.
- b. Corresponding coverage in DFARS and AFARS.
- c. DoD 5500.7-R, Joint Ethics Regulation (JER).
- d. IG DoD 4075.1-H, Indicators of Fraud in DoD Procurement.
- e. DA PAM 27-153, Contract Law.

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